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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of Federal-State Joint Board on Universal Service	CC Docket No. 96-45 and 97-~~106~~160, DA 98-715

CALIFORNIA'S COMMENTS ON PROPOSALS TO REVISE THE METHODOLOGY FOR DETERMINING UNIVERSAL SERVICE SUPPORT

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I. INTRODUCTION

The People of the State of California and the Public Utilities Commission of the State of California ("California" or "CPUC") hereby file these comments in response to the Federal Communication Commission's ("FCC") Public Notice 98-715. By this notice, the FCC seeks comment on alternate proposals for modifying the FCC's methodology for determining the appropriate level of federal universal service support to high cost areas. In these comments, California responds to the proposals submitted by BellSouth, the Staff of the Colorado Public Utilities Commission, GTE, the

NARUC Ad Hoc Working Group, the South Dakota Public Utilities Commission, Sprint and US West. California's comments reflect the past positions it has taken in the FCC's Universal Service proceeding as well as the actions the CPUC has taken in establishing its own intrastate universal service programs.

In general, California supports a federal universal service mechanism for funding high cost areas which embodies the following principles: (1) the methodology uses forward-looking costs to determine high cost support; (2) federal support is targeted to exceptionally high cost areas, that is, areas that exceed a multiple of the nationwide average cost; (3) the high cost support fund does not exceed the overall level of funding contemplated by the FCC's Universal Service Order, FCC 97-157; (4) the high cost support mechanism is tempered in order to minimize the burden on those that contribute to it and to reduce distortions in the marketplace caused by such mechanism; (5) contributions to the federal high cost support mechanism continue to be based solely on interstate revenues; (6) recovery of federal contributions continue to be made only through charges associated with interstate services; and (7) the methodology for determining high cost support is administratively simple to use and apply. All of these principles are consistent with the Telecommunications Act of 1996 ("1996 Act").

In addition, any methodology the FCC adopts should employ a cost-based benchmark. This benchmark should be based on a multiple of the nationwide average cost. If the FCC wants to direct more high cost funding to areas which do not have sufficient resources due to low intrastate revenue and high overall costs, then the FCC should employ a variable benchmark. The federal high cost support should be determined by the difference between the forward-looking cost of providing designated services and the cost-based benchmark.

Moreover, the FCC should not attempt to address issues concerning access rate structures that are unrelated to high cost through the high cost program. Finally, the federal high cost program should be funded by a surcharge on interstate end user bills which reflects the FCC's end user interstate revenue assessment base.

II. PROPOSALS TO TARGET HIGH COST FUNDING

The FCC received a variety of proposals for better targeting high cost support to the areas that need it most. Achievement of this end does not necessarily require a larger fund than that contemplated by the FCC in its Universal Service Order, FCC 97-157, only one that better targets high cost funding resources. These proposals are intended to address the needs of high cost areas without creating a bloated subsidy program which can never be reduced or eliminated. California will comment on four of these proposals: the Interstate High Cost Affordability Plan ("IHCAP") proposed by US West, the Variable Benchmark Option introduced by South Dakota, the Variable Support Option proposed by South Dakota and Colorado, and the NARUC Ad Hoc Working Group Proposal ("Ad Hoc proposal").

In general, while not subscribing to US West's specific parameters, California believes that the underlying approach of the IHCAP in limiting federal responsibility for high cost areas through a benchmark mechanism is appropriate. In addition, if the FCC wants to alter the amount an eligible telecommunications carrier receives based on the resources available within a state, the FCC should do so by varying the benchmark between states rather than varying the amount of support. Finally, if the FCC considers adopting the Ad Hoc proposal, the proposal should be greatly streamlined and then only be considered as an interim solution due to its reliance on embedded costs.

Specifically, US West's IHCAP proposes a plan that includes a two-tiered benchmark. Under this plan there would be a "Super Benchmark" of $50. The federal program would support 100% of the costs exceeding this benchmark. In addition, there would be a "Primary Benchmark" of $30.

The federal program would support 25% of the difference between the Primary and Super Benchmarks. The Super Benchmark represents a demarcation between federal and state responsibility. US West's general approach roughly corresponds to the CPUC's position that the federal fund should target exceptionally high cost areas that exceed some multiple of the nationwide average.

The Variable Benchmark Option introduced by South Dakota would allow the FCC to direct more high cost funding to areas with limited internal resources. The Variable Benchmark Option would enable the FCC to target more support to states that have greater need due to small interstate revenue bases or generally higher costs. The plan would be based on the forward-looking cost of providing designated services and target small geographic areas. It would ensure that the highest cost areas throughout the nation receive high cost funding.

The Variable Support Option shares many of the features of the Variable Benchmark Option; however, the Colorado staff's version of this plan may result in high cost areas in some states not receiving any support at all. The reason is that a band which determines whether or not a state receives support effectively excludes some states.[1]

The Ad Hoc proposal contains two features which California supports for the federal universal service program: the proposal results in a relatively modest sized universal service fund, and the proposal would be funded only through interstate ~~rates~~. However, the Ad Hoc proposal also has several features which California cannot support. First, while California does not oppose the underlying premise of the Ad Hoc proposal that certain areas may need more support than others because of underlying conditions, the Ad Hoc proposal is unduly complex for an interim program. Second, the proposal relies in part on embedded costs instead of solely on forward-looking costs. And third, the proposal fails to direct support to the highest cost areas of the country.

Specifically, the Ad Hoc proposal uses a variety of cost measures, hold harmless schemes and administrative mechanisms. The proposal's methodology uses both embedded and forward-looking costs, neither of

[1] Comments of the Colorado Public Utilities Commission Staff Regarding Options for Consideration, p. 3.

which have been developed yet. The embedded cost measure would incorporate switching and transport costs which are not currently used by any carriers to estimate federal universal service support. The forward-looking cost measure is in the process of being developed. In most states, the use of these cost measures would be replaced by a "hold harmless" provision. The proposal defines two hold harmless provisions: "Part A," which ensures that carriers in states that would not qualify for support based on the statewide average cost that currently receive support would continue to receive support and another, "Part B," which funnels additional support back to states that have high overall embedded costs. The hold harmless provisions determine not only how much support a state will receive, but also affect how support is distributed within the state. In cases where the hold harmless provision applies, carriers receive funding directly from the federal administrator of the high cost program. In cases where the hold harmless does not apply, the distribution and administration of funding is under the control of the state. As explained below, California believes that Ad Hoc proposal, intended to be only an interim solution, is far too complex and impractical. [2]

[2] "High Cost Support: An Alternative Distribution Proposal" p. 26

One aspect of the Ad Hoc proposal which is at odds with California's position in this proceeding is its reliance on embedded costs. The Ad Hoc plan relies on embedded costs in three respects. First, the plan uses statewide embedded costs to determine the level of support. Second, the "hold harmless A" mechanism indirectly relies on embedded costs to the extent that the loop portion of existing high cost support, which represents the bulk of this support, is based on embedded costs. Third, the "hold harmless B" provision appears to be based on embedded cost.[3] As a result, in only five out of fifty states is funding based on forward-looking economic costs.

While a great deal of attention has been given to the problems with forward-looking economic cost models, California believes that models based on embedded cost are also problematic. Embedded costs are an integral part of rate-of-return regulation. As states have moved to price cap regulation for large carriers, embedded costs have had a diminished role, and consequently have received less attention. California moved to a price cap regime for its two largest local exchange carriers in 1989. Embedded costs have even less relevance in a competitive market as carriers invest in

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[3] "High Cost Support: Alternative Distribution Proposal, p. 21.

networks that provide a wide array of services beyond the designated services.

The FCC faces a more formidable challenge in estimating costs than any particular state due to the heterogeneous conditions among the states affecting the cost of providing designated services. If the FCC chooses to rely on an embedded cost methodology, California believes that the FCC should do so only for a limited time until it has greater confidence in forward-looking economic cost models.

Another problem with the Ad Hoc proposal is that it fails to direct high cost support to the highest cost areas throughout the nation. If a high cost area is served by a local exchange carrier that has not received support in the past and is in a low cost state, no support will be available through the federal program. California has consistently taken the position that the federal high cost program should be directed to exceptionally high cost areas throughout the country.

Notwithstanding all of the above, if the FCC is concerned about the quality of forward-looking costs and thus wishes to rely for an extended period of time on a methodology using embedded costs, it should use a streamlined version of the Ad Hoc proposal which uses a single cost standard, a single hold harmless mechanism, a single administrative system and the existing 115% threshold for determining high cost.

III. UNIVERSAL SERVICE AND ACCESS CHARGES

In their proposals, GTE and Bell South argue that universal service funding should be determined based on the alleged implicit subsidies found in interstate access charges. While California does not take a position on the merits of GTE's or BellSouth's criticism of the access rate charge structure, California believes that the problems that GTE and BellSouth raise are best addressed within the context of access rates, and are not high cost issues.

Specifically, GTE asserts that at a minimum "implicit subsidies must be eliminated."[4] GTE argues that Section 254 of the 1996 Act is "an unambiguous mandate to the Commission to replace the current system of implicit subsidies embedded in rates."[5] Although not directly referring to access rates, Sprint similarly asserts a "prohibition on implicit subsidies contained in Section 254.

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[4] Proposal of GTE, p. 8.
[5] Proposal of GTE, p. 7.

Section 254 indicates that only support that is necessary to accomplish the mandates of the Act should be provided and that this support should be specific and explicit. In California's view, the 1996 Act does not require that every alleged implicit subsidy should be replaced with a new explicit one, but allows the FCC to eliminate these subsidies if they are unnecessary to achieve the mandates of the Act.

It is unclear in what sense implicit subsidies are related to high cost. GTE calculates its estimate of the implicit subsidy by comparing switched access revenues from non-rural local exchange carriers with the cost of access.[6] GTE's calculation suggests that at least part of the implicit subsidy results from the fact that the forward-looking cost of providing switched access is appreciably lower than the embedded cost. However, this would tend to be true in low cost as well as high cost areas. Hence, the alleged subsidy problem is not uniquely a high cost issue.

By proposing to use high cost support to reduce the presubscribed interexchange carrier charge ("PICC"), Bell South suggests that such charge is a an implicit subsidy.[7] To the extent that this charge has been passed through to end user customers, it is difficult to see how it constitutes an

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[6] Proposal of GTE, p. 14, footnote 27.

implicit subsidy. Moreover, to the extent that the charge differs between classes of customer, this suggests that the issue concerns the access rate structure rather than a high cost issue. It also appears that BellSouth's proposal would only affect Carrier Common Line Revenues and PICCs to the extent a company receives support based on an economic cost. If a company were to receive no support under the adopted forward-looking cost based approach, then BellSouth's proposal would not affect the alleged implicit subsidies present in the PICC and other access charges.

In short, California believes that the problems identified by GTE and BellSouth are problems with the access charge rate structure, and are not universal service issues. Except to the extent that the resolution of such problems would lead to exceptionally high prices in exceptionally high cost areas, these problems are not universal service issues that should be addressed here.

IV. FUNDING

California believes that the high cost program should be funded through an explicit surcharge on interstate end user billings on each

[7] BellSouth Comments, Attachment 1, p. 1.

customer's bill. The surcharge would mirror the interstate revenue assessment base adopted in FCC 97-157 so that it would apply not only to interstate toll calling, but also to the subscriber line charge. This method would reduce customer confusion and ensure that the correct amount is raised for the high cost program. California does not believe that carriers should assess the surcharge on both intrastate and interstate billings. California has several end user surcharges based on intrastate billings. Carriers have managed to implement this with little difficulty separating interstate and intrastate revenues.

V. CONCLUSION

California has pointed out the strengths and weaknesses of several of the proposals tendered to the FCC for revising the methodology for funding

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universal service support for high cost areas. At bottom, any revision to the FCC's existing methodology should comport with the principles which California has identified.

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May 14, 1998

CERTIFICATE OF SERVICE

I, Ellen S. LeVine, hereby certify that on this 14th day of May, 1998, a true and correct copy of the foregoing document entitled California's Comments On Proposals To Revise The Methodology For Determining Universal Service Support was mailed first class, postage prepaid to all parties on the attached service list.

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